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AGENDA ITEM 7b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Member Home Loan Program Update

II. PROGRAM: Member Home Loan Program

III. RECOMMENDATION: Information Only

IV. ANALYSIS:

During the March 19, 2008 Chief Investment Officer's Report to the Board of Administration , the Board asked staff to report back as to whether CalPERS members were having difficulty obtaining loans through the Member Home Loan Program ("MHLP") in light of the current credit crunch.

In response, staff in coordination with CalPERS MHLP program manager, CitiMortgage, examined the following factors in order to determine if our members are having difficulty obtaining loans through the program:

- MHLP volume trends.
- Changes to Fannie Mae ("FNMA") and private mortgage insurance standards.
- Declines in California real estate values.

Contrary to general industry trends reported by the press, staff found that the CalPERS MHLP has experienced an increase in loan volumes since the credit crisis started; however, it is clear that FNMA and the mortgage insurers have modified their risk based pricing models. The action by FNMA and the mortgage insurers, since the onset of the credit crisis, has effectively raised mortgage rates by charging higher mortgage fees.

Staff has historically taken a proactive approach to protecting CalPERS members from future financial hardship by carefully selecting a conservative mortgage product offering. The more common "affordability mortgages" available outside the MHLP which included no documentation, negative amortization and sub-prime loans allowed individuals to purchase homes that many were ultimately unable to afford. These affordability mortgages for all intents and purposes are now unavailable in the mortgage market. In prior years, CalPERS' MHLP decision to offer only better underwritten mortgage products hurt volumes when borrowers were looking for affordability mortgages. However, the mortgage industry's return to more traditional underwriting standards like those employed in the MHLP has the potential to increase demand for the products being offered within the MHLP.

As a result of FNMA risk based pricing changes, CalPERS members have witnessed tighter underwriting standards and higher fees on their mortgages. In 2007, FNMA tightened their underwriting standards and increased loan fees which included:

- FNMA reduced the maximum loan-to-value by 5% in areas that have declining real estate values. Many California counties have witnessed price declines; as a result, our members are required to come up with an additional 5% as a down payment.

- FNMA charges all borrowers an "adverse market fee" in an effort to stem expected losses due to the subprime mortgage crisis. This fee adds 25 bp on the initial loan amount for conventional conforming loans.

- FNMA charges borrowers progressively higher fees for lower credit scores. These higher fees range from 75 to 200 bp on the initial loan amount.

- FNMA charges higher fees to borrowers requesting higher loan amounts relative to property values. These higher fees range from 25 to 75 bp on the initial loan amount. FNMA fees are cumulative and may amount to several thousands of dollars for an average loan, thereby making it more costly for some members to obtain financing.

Decreasing or negative home equity also makes it more difficult for some members to obtain financing. According to the California Association of Realtors, home prices in California decreased by 13.6% in 2007 which impacts members seeking to refinance their homes. Historically, approximately 70% of MHLP loans are refinance loans. As a result, staff expects mortgage refinancing volumes could be under pressure going forward.

Recent changes in the mortgage insurance industry have affected our members including:

- Previously, members could seek second loans or home equity loan products to keep their first mortgage under 80% of the property's value and hence avoid private mortgage insurance ("PMI"). Many lenders no longer offer these second loan or home equity loan products. Thus, some members must seek higher loan-to-value first mortgages instead and be subject to tougher PMI standards.

In summary, CalPERS MHLP continues to offer our members access to high quality mortgage loans for home purchases and refinancing. However, it is clear that changes to FNMA loan standards, higher loan fees, declining real estate values and general mortgage industry trends have impacted members cost and access to mortgages.

V. STRATEGIC PLAN:

Monitoring and review of CalPERS Member Home Loan Program is consistent with Goal V: Provide sustainable pension benefit products and services responsive to and valued by members, employers and stakeholders.

VI. RESULTS/COSTS:

This item is provided for information only.

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